June 4, 1999

VIA ELECTRONIC &
REGULAR MAIL

Mr. Tom Fry
Acting Director
Bureau of Land Management
Department of Interior
1849 C Street, NW
Room 5660
Washington, DC 20240
Facsimile (202) 208-5242

Re: Onshore Oil and Gas Leasing and Operations

Dear Mr. Fry:

The Office of Advocacy of the U.S. Small Business Administration (SBA) was established by Congress under Pub. L. No. 94-305 to advocate the views of small business before federal agencies and Congress. Advocacy is also required by §612(a) of the Regulatory Flexibility Act (RFA) (5 U.S.C. 601-612) to monitor agency compliance with the RFA. The Chief Counsel of Advocacy is authorized to appear as *amicus curiae* in regulatory appeals from final agency actions, and is allowed to present views with respect to compliance with the RFA, the adequacy of the rulemaking record with respect to small entities, and the effect of the rule on small entities. Id. On March 28, 1996, President Clinton signed the Small Business Regulatory Enforcement Fairness Act (SBREFA), Pub. L. 104-121, which made a number of significant changes to the RFA, the most significant being provisions to allow judicial review of agencies' compliance with the RFA. 5 U.S.C. § 611.

On December 3, 1998, the Bureau of Land Management (BLM) published a proposed rule on Onshore Oil and Gas Leasing Operations, Federal Register, Vol. 63, No. 232, p. 66840. The purpose of the proposed rule is to revise Federal oil and gas leasing and operations regulations. Among other things, the rule will increase the minimum bond amounts for individual and statewide operators; impose a fee for inactive wells; and change the procedure for imposing penalties for uncorrected violations.

Regulatory Flexibility Act Requirements

The RFA requires administrative agencies to consider the effect of their actions on small entities, including small businesses, small non-profit enterprises, and small local governments. See 5 U.S.C. §§ 601, et. seq.; Northwest Mining Association v. Babbitt, 5 F. Supp. 2d 9. When an agency issues a rulemaking proposal, the RFA requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" which will "describe the impact of the proposed rule on small entities." 5 U.S.C. § 603(a); *Id.*.

Initial Regulatory Flexibility Analysis

If the proposed rule is expected to have a significant economic impact on a substantial number of small businesses, an initial regulatory flexibility analysis (IRFA) must be prepared and published with the proposed rule. The required IRFA is prepared in order to ensure that the agency has considered all reasonable regulatory alternatives that would meet the agency's policy objectives but minimize the rule' s economic impact on affected small entities. In accordance with Section 603(b) of the RFA, each IRFA must address the reasons that an agency is considering the action; the objectives and legal basis of the rule; the type and number of small entities to which the rule will apply; the projected reporting, record keeping, and other compliance requirements of the proposed rule; and all federal rules that may duplicate, overlap or conflict with the proposed rule.

Certification

Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an IRFA, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities. If the head of the agency makes such a certification, the agency shall publish such a certification in the Federal Register at the time of the publication of the general notice of proposed rulemaking for the rule along with a statement providing the factual basis for the certification. *Id.*

RFA Non-Compliance in Proposed Rulemakings

BLM's Certification Does Not Comply with the Requirements of the RFA

In the above referenced proposal, the BLM did not prepare an IRFA. Instead, it opted to certify the proposal. The certification states that the proposal will not have a significant economic impact on a substantial number of small entities. BLM asserts that the only provisions of the proposal that will have an impact on a substantial number of small entities are the bonding provisions. BLM contends, however, that that impact will not be significant.

BLM Failed to Provide a Definition for Significant Impact

In its certification, BLM does not provide any information about the guidelines that it used

in its threshold analysis for defining "significant". Without BLM's definition of significant, the public is unable to ascertain whether there is a true factual basis for BLM's conclusion of "no significant impact". The Office of Advocacy asserts that by not providing its definition of significant, BLM has compromised the public's ability to review the information, analyze BLM's findings, and provide meaningful comments.

Since BLM did not provide information on its definition of significant, the Office of Advocacy consulted with Advocacy's Office of Economic Research for guidance on determining a "significant impact" when reviewing profit data. According to the Office of Advocacy's Office of Economic Research, a 10% impact on a business's profits is indeed significant. The Office of Advocacy, therefore, will use a 10% threshold for the purpose of this comment.

The Impact of the Bonding Proposal May Be Significant

Under the proposal, individual bonds will be increased from $10,000 to $20,000; statewide bonds will increase from $25,000 to $75,000; and nationwide bonds will remain at $150,000. Federal Register at 66842. BLM contends that the increases in local and statewide bonds are necessary because small operators are less likely to meet their reclamation requirements. Furthermore, the bonds have not been increased since 1960. *Id.*

BLM estimates that the actual impact will be $43 per well per year; it asserts that such an impact is small. BLM provides an example of the overall impact of the regulation on small entities. In the example provided, BLM states that at a profit of $2 per barrel, the additional bonding cost would be covered by the profit from 3 weeks of production. Federal Register, at 66864. Simple arithmetic indicates that 3 weeks is 6% of a 52-week year. A proposal, therefore, that uses three weeks of a company's profit would amount to a minimum of approximately 6% of the business's annual profit, assuming that the wells are active for the entire year.

While 6% does not reach the threshold that Advocacy has established for determining significant economic impact, the impact is 6% only if the wells operate productively for every week out of the year. If the wells do not operate for the entire year, the impact on the small entities increases. As the weeks of operation decrease, the percentage of profits used will increase. For example, if the wells only operate for 30 weeks of the year, then the impact of the proposal would be 10% of the profits.

BLM Failed to Consider the Aggregate Impact of the Proposal

Furthermore, it is unclear to Advocacy whether BLM has considered the aggregate impact of this proposal. In addition to the bonding requirement, the producers will also have to pay a $100 fee for inactive wells. While the $100 per well fee may not be significant, the fee plus the bonding requirement may impose a significant burden on a small entity. Accordingly, the Office of Advocacy asserts that BLM should consider more information on the practices of the industry and the aggregate impact of the proposal before simply certifying the proposal and dismissing the impact as not significant. Failure to do so

deprives the public of information that may be instrumental for facilitating meaningful public comments.

BLM's Certification Is Not Supported By a Factual Basis as Required by the RFA

The Office of Advocacy has steadfastly maintained that an agency must conduct a threshold analysis prior to certifying that a rule has "no significant economic impact". The threshold analysis provides the agency with the type of information required for formulating a factual basis. From the information provided, the Office of Advocacy is unable to determine whether BLM performed a threshold analysis to assure that its certification of "no significant economic impact," is not arbitrary but is supported by factual knowledge of the industry that may be affected by the agency's actions.

BLM's failure to provide information on its definition of "significant economic impact", failure to provide crucial information on the nature of the industry (i.e. the number of weeks that the wells are in operation per year) and failure to publish an analysis of the aggregate impact of the proposal hinders the notice and comment process. Without this information, neither the Office of Advocacy nor the public can determine the factual basis for BLM's certification of "no significant impact". The reason that a factual basis must be provided for comment is to assure that the agency has a basis for its regulation and that it will not effect competition.

Eliminating Major and Minor Classification of Violations and Simplifying Assessment Structure Promotes Bad Public Policy

Under the current regulations, violations are classified as major violations and minor violations. Major violations are actions that, if left uncorrected, could cause immediate, substantial, and adverse impacts to public health and safety, production accountability, or the environment. Minor violations are violations that do not rise to the level of major violations. Operators are liable for an assessment of up to $500 per day if the violation is not corrected within a time specified by BLM. Minor violations are subject to a one-time assessment of $250, if the violation is left uncorrected. Federal Register, at 66867.

Pursuant to the proposal, all violations, major and minor, will be treated the same; operators will be required to pay $250 per day for uncorrected violations. The proposal eliminates all caps on uncorrected violations. Id. Accordingly, under the proposal, if a minor violation is left uncorrected for a one week period, the operator will be liable for $1,750-- $1,250 more than the prior penalty of $250 per violation.

The information in the proposal states that in the last four years an average of 2,735 citations were issued per year for major violations and 13,752 citations were issued per year for minor violations. Accordingly, the vast majority of the violators were liable for a maximum penalty of $250. Of those citations, less than 7% of the major violations and less than 1% of the minor violations have resulted in assessments. Id.

BLM asserts that the potential for an assessment promotes compliance. Id. Moreover,

BLM believes that the removal of the cap and the increased assessment will decrease the number of minor penalties. Id. at 66867-66868.

The Office of Advocacy commends BLM for publishing the proposed changes in the penalty procedure for public notice and comment. In that the changes may have a significant economic impact on a substantial number of small businesses, public comment is crucial to assure fair policymaking at all stages of the process, including the imposition of penalties. Such an implementation policy could be unduly burdensome on a small business with minor violations and deserves the public scrutiny that BLM has allowed.

Advocacy, however, questions whether the proposed policy will meet the stated objectives of BLM, i.e. to encourage compliance and reduce the potential for environmental problems. The data provided by BLM indicates that although 13, 752 citations were issued for minor violations, less than 1% of minor violations result in assessments. Did the minor violators have knowledge of regulations or basis of the violation prior to the citation? Moreover, is the low percentage of assessments an indication of a minor violator's willingness to address the issue in an expeditious matter? If the violations were a result of a lack of knowledge, would educating the businesses about the requirements, prior to the occurrence of a violation, be a better mode of achieving compliance?

Furthermore, is the higher percentage of assessments to major violators an indication of a greater rate of recalcitrance among major violators? If so, does the proposal reward the major violators' poor behavior by lowering the assessment rate for major violations? If a major violation is a greater risk to the public than a minor violation, will the proposal policy be perceived as rewarding the behavior of major violators while being unnecessarily punitive to minor violators? If the overall penalty amount for major violators is decreased, will the new penalty policy truly meet the stated objectives of BLM to encourage compliance and protect the public?

Moreover, the proposal appears to be contrary to the intent of the President's Memorandum on Regulatory Reform. On April 21, 1995, President Clinton issued a memorandum that directed agencies to modify the penalties for small businesses in situations that do not involve a significant threat to health, safety or environment. (See attachment). Making allowances for small businesses that commit minor violations would not only comply with the President's memorandum, it would also be good public policy.

BLM Should Consider Alternatives to the Proposal

As noted previously, it is quite possible that this rulemaking will have a significant economic impact on a substantial number of small entities. If so, then BLM must prepare an IRFA. A major component of an IRFA is the consideration of alternatives.

The industry has told Advocacy that the increase in the bond is not necessary because the additional reclamation costs will be covered by the $100 fee on inactive wells. The Office of Advocacy asserts that the alternative submitted by the industry should be considered. If the needs of the agency can be addressed through the inactive well fee, the

imposition of the additional bonding requirement may be unduly burdensome. Consideration and publication of alternatives is necessary to assure the public that BLM has attempted to mitigate the consequences of this action

Conclusion

The Office of Advocacy recognizes the importance of protecting the environment and assuring reclamation of the drilled areas. As such, our comments should not be interpreted as attempting to discourage BLM from promulgating regulations or requesting that BLM change its proposal. Advocacy is simply requesting that the agency provide evidence that it has considered the economic impacts of the proposal and the interests of small businesses in drafting the proposal as well as the potential economic costs to the public if small oil well operators are put out of business.

The requirements of the RFA are not intended to prevent an agency from fulfilling its statutory mandate. Rather it is intended to assure that the economic impacts are fairly weighed in the regulatory decision making process. The public has an interest in knowing the potential economic impact of a particular proposed regulation. As the court stated when remanding a rule to the agency in Northwest Mining v. Babbitt, "While recognizing the public interest in preserving the environment, the Court also recognizes the public interest in preserving the rights of parties which are affected by government regulation to be adequately informed when their interests are at stake and to participate in the regulatory process as directed by Congress."*Supra.* at 13.

If you would like to discuss this matter or if this office can be of any further assistance, please contact Jennifer A. Smith, Assistant Chief Counsel for Economic Regulation. She may be reached either by mail at the above address or by telephone at (202) 205-6943.

Thank you for your attention to this matter.

Sincerely,

Jere W. Glover
Chief Counsel
Office of Advocacy

Sincerely,

Jennifer A. Smith
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CC: Bureau of Land Management
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